

City of Detroit

CITY COUNCIL

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TO: COUNCILMEMBERS

FROM: Irvin Corley, Jr., Director *ICJ*.

DATE: September 19, 2005

RE: Certificate of Participation (COP) Covering 80% of the Unfunded
Accrued Actuarial Liabilities (UAAL) of the Retirement Systems

At last Thursday's City Council session it was requested that I provide Council Members with the documentation that supports my analysis that the recent Certificate of Participation sale covers only 80% of the outstanding UAAL of the retirement systems. Attached you will find copies of the cover and pages six and seven from the Official Offering Circular for the sale. I received this circular about two weeks ago. On the copy of page six you will find an outline paragraph near the middle of the page that details the amount of the sale and the UAAL as of June 30, 2004. The table below calculates the percentage of the total UAAL that the sale represents for each system and in total.

System	June 30, 2004 UAAL	COP Sale Amount	Percentage
General	\$913,683,202	\$739,793,898	80.97%
Policemen and Firemen	\$782,976,693	\$630,829,189	80.57%
Total	\$1,696,659,895	\$1,370,623,087	80.78%

The total on the above chart for the COP Sale Amount of \$1,370,623,087 matches the amount on page seven for the Uses of Funds – Subject UAAL.

Council should note, however, that even though only 80% of the June 30, 2004 UAAL of both pension systems was funded via the COP sale, the transaction did successfully achieve the targeted \$80 million in interest savings for the last fiscal year, fiscal 2004-05. In fact, the transaction provided over \$86.7 million in interest savings. I am unclear, however, how much, if any of this amount maybe distributed to other funds, such as Water and Sewerage.

I still wonder, however, why the remaining 20% of the UAAL was not refinanced. Why not produce additional savings to help reduce the pending \$126 million deficit anticipated as of June 30, 2005. It would be great for the Finance Department to provide an answer to this question.

I trust this provides City Council with the necessary supporting information concerning the sale of the COP's in relation to the UAAL.

Attachments

cc: Council Divisions
Auditor General's Office
Sean Werdlow, Chief Financial Officer
Donita Crumpler, Manager II, Finance
Roger Short, Budget Director
Anthony Adams, Deputy Mayor
Kandia Milton, Mayor's Office

New Issue - Book-Entry Only

D4C Bond

This Offering Circular provides information about the Certificates. Information on this cover page is for ready reference. A prospective investor should read the entire Offering Circular to make an informed investment decision.

\$1,440,000,000
TAXABLE CERTIFICATES OF PARTICIPATION SERIES 2005
issued by the **DETROIT RETIREMENT SYSTEMS FUNDING TRUST 2005**

evidencing undivided proportionate interests
in the rights to receive certain payments
pursuant to two Service Contracts between

CITY OF DETROIT, MICHIGAN

and

DETROIT GENERAL RETIREMENT SYSTEM SERVICE CORPORATION

and

DETROIT POLICE AND FIRE RETIREMENT SYSTEM SERVICE CORPORATION

\$640,000,000 SERIES 2005-A (FIXED RATE)

\$800,000,000 SERIES 2005-B (FLOATING RATE)

Dated: Date of Delivery

Due: June 15 as shown on the inside cover

Ratings

See page 20

Interest Payment Dates

Series 2005-A: December 15, 2005 and each June 15 and December 15 thereafter
Series 2005-B: September 15, 2005 and the 15th day of each December, March,
June and September thereafter

Redemption

Series 2005-A Certificates maturing in 2020 and 2025 are subject to *pro rata* mandatory sinking fund redemption at par.
—See page 9
Series 2005-A Certificates are subject to optional redemption on any date with a make-whole premium.
—See pages 9-10
Series 2005-B Certificates maturing in 2014 and 2025 are subject to *pro rata* mandatory sinking fund redemption at par.
—See pages 12-13
Series 2005-B Certificates are subject to optional redemption on any Interest Payment Date at par, beginning June 15, 2007.
—See page 13

Source of Payment

Principal of and interest on the Certificates are payable, when due, solely from COP Service Payments to be paid by the City under the Service Contracts.—See pages 7-8

Insurance

The scheduled payment of principal of and interest on the Certificates will be guaranteed under the insurance policies (as specifically indicated on the inside cover of this Offering Circular with respect to particular Certificates) to be issued concurrently with the delivery of the Certificates by Financial Guaranty Insurance Company and XL Capital Assurance Inc.

FGIC Financial Guaranty Insurance Company

XL CAPITAL ASSURANCE

Tax Matters

Interest on the Certificates is subject to U.S. federal income tax and State of Michigan income tax.

Purpose

The Certificates are being issued to provide moneys to fund certain unfunded accrued actuarial liabilities of each Retirement System of the City.—See pages 5-7

Denominations

Series 2005-A: Multiples of \$5,000
Series 2005-B: \$25,000 and multiples of \$1,000 in excess thereof

Closing

On or about June 2, 2005

Global Book-Entry System

Clearance is expected to be available through The Depository Trust Company (the depository for the Certificates), Clearstream, and Euroclear.

Global Offering

The Certificates are offered globally for sale in jurisdictions where it is lawful to make such offers.—See page 19

Stock Exchange Listing

Application will be made for the Certificates to be listed on the Luxembourg Stock Exchange. There can be no assurance that this listing will be obtained. The issuance and settlement of the Certificates is not conditioned on the listing of the Certificates on the Luxembourg Stock Exchange.

Certificate Counsel

Lewis & Munday, A Professional Corporation—See page 21

Trustee

U.S. Bank National Association

Book-Running Manager

UBS Financial Services Inc.

Co-Senior Managers

Citigroup Global Markets (Series A only)

Loop Capital Markets, LLC (Series A & B)

Merrill Lynch & Co. (Series A & B)

Morgan Stanley (Series A & B)

Siebert, Brandford, Shank & Co., LLC (Series A only)

Co-Managers for Series 2005-A Certificates Only

ABN AMRO Financial Services, Inc. **A.G. Edwards & Sons Inc.** **Bear, Stearns & Co. Inc.** **Capital Management Group Securities, LLC**

Comerica Securities **First Albany Capital** **JPMorgan** **Lehman Brothers** **M.R. Beal & Company**

Oppenheimer & Co., Inc. **Popular Securities, Inc.** **Raymond James & Associates, Inc.**

This Offering Circular is dated: May 25, 2005

Michigan's Public Employees Retirement System Investment Act provides more specificity. That statute, which applies to both the GRS and PFRS, prescribes (in MCL §38.1140m) that a Michigan municipality's required annual contribution to its employee retirement system must be an actuarially determined contribution amount, consisting of (1) a current service cost payment, (2) a payment of at least the annual accrued amortized interest on any UAAL and (3) a payment of the annual accrued amortized portion of the unfunded principal liability.

It is customary for Michigan cities to provide detailed specifics for meeting their UAAL funding obligations in their city ordinances. The City's GRS and PFRS ordinances have long specified a traditional funding mechanism for the City to meet its constitutional and statutory obligation to provide funding for each System's UAAL through required annual payments. The City recently authorized an alternative funding mechanism for such UAAL through new enabling legislation duly enacted by the Detroit City Council, Ordinances No. 03-05 and 04-05 (**Alternative Funding Mechanism Ordinances**) amending the City's GRS and PFRS ordinances. The Alternative Funding Mechanism Ordinances, together with the Funding Ordinance (No. 05-05), enable the City, the Service Corporations and the Trustee to provide for the issuance and sale of the Certificates and the use of the Certificate proceeds to fund the Subject UAAL of both Retirement Systems on the Closing Date.

Each Retirement System receives an annual actuarial report from its consulting actuary as of each June 30, providing actuarial valuations of its vested benefits, prior service costs and unfunded accrued liabilities. Each Retirement Board uses those actuarial valuations, together with certain actuarial assumptions, to determine the annual contribution amounts requested from the City to fulfill its constitutional and statutory pension funding obligations. As part of their regular, periodic review of the actuarial assumptions used to administer their respective Retirement Systems, the GRS and PFRS Retirement Boards may receive recommendations from time to time to increase or decrease the interest rate and to change other actuarial assumptions.

The most recent annual actuarial reports available for the Retirement Systems are as of June 30, 2004. Although the GRS and PFRS had assets actuarially valued at \$2,470,243,470 and \$3,074,516,589, respectively, as of that date, they also had estimated UAAL of \$913,683,202 and \$782,976,693, respectively, as of that date, as determined by their actuary. \$739,793,898 of GRS UAAL and \$630,829,189 of PFRS UAAL are the "**Subject UAAL**" to be funded in full from Certificate proceeds on the Closing Date.

The Subject UAAL is a major part, but not all, of the existing UAAL of the Retirement Systems. The funding of the Subject UAAL from Certificate proceeds is not intended to and will not fund the entire existing UAAL of either or both Retirement Systems.

Under the Retirement Boards' current actuarial assumptions and the traditional funding mechanism, the City would be required to amortize the Subject UAAL over a remaining period of 13 years for the PFRS and 20 years for the GRS. In each year that the City has outstanding UAAL, it is assessed interest thereon (currently at annual rates of 7.9% on GRS UAAL and 7.8% on PFRS UAAL).

By arranging through the alternative funding mechanism for the Subject UAAL to be funded (in effect, prepaid) on the Closing Date, the City will avoid further interest accrual on the amount thus funded; and the Retirement Systems will have possession and control of those funds (including the exclusive right to invest and receive all investment earnings on those funds) much sooner than they would under the traditional funding mechanism. The Alternative Funding Mechanism Ordinances impose certain technical restrictions on the Retirement Systems' uses of those funds, but neither rescind any substantive rights, entitlements or obligations with respect to benefits earned or accrued of members, retirees or beneficiaries of the Retirement Systems nor affect the validity or enforceability of the Service Contracts or the City's payment obligations thereunder.

The financing plan reflects the expectation that by prepaying the Subject UAAL, the City will reduce its costs and better ensure the timely and full payment of retirement benefits. As a practical matter, it is

expected that amounts that otherwise would have been expended by the City for the annual amortization of the Subject UAAL (under the traditional funding mechanism) will be sufficient to offset all of the Contract Payments to be made by the City under the Service Contracts. Those Contract Payments are intended to replace payments the City would otherwise make to meet its constitutional obligation to amortize the Subject UAAL.

Apart from the Subject UAAL, other unfunded accrued actuarial liabilities of the Retirement Systems may exist and arise in the ordinary course of the City's operations, which the City may elect to fund by utilizing the traditional funding mechanism or the alternative funding mechanism. Any utilization of the alternative funding mechanism for such other unfunded accrued actuarial liabilities would, however, require (i) separate authorization by a future enabling ordinance of the City enacted for that purpose; (ii) a new funding trust separate and distinct from the Funding Trust; (iii) one or more new service contracts separate and distinct from the Service Contracts; and (iv) issuance of new certificates of participation unrelated to the Certificates.

Swap Agreements

It is expected that the Service Corporations will enter into interest rate exchange agreements or similar agreements (**Swap Agreements**) before or at the time of issuance of the Series B Certificates, to hedge variable-rate exposure under the Service Contracts, and they may do so from time to time with respect to any rate exposure under the Service Contracts. Payments under a Swap Agreement may include net payments based on the interest rates exchanged. Under the Swap Agreements, the Service Corporations will be obligated in certain instances to make periodic payments to the Swap Agreement counterparty, and should a Swap Agreement be terminated, under certain circumstances the Service Corporations may be required to pay a termination payment. The Service Corporations' obligation to make all payments under the Swap Agreements will be payable from moneys paid by the City under the Service Contracts. In applying moneys so received from the City, the Contract Administrator will be required to treat any termination payment owing to a Swap Agreement counterparty as subordinated in right of payment to the prior payment in full of any Scheduled Payments and Service Charges (corresponding to principal of and interest on Certificates) then due and unpaid.

Sources and Uses of Funds

The proceeds from the sale of the Certificates are expected to be used as follows:

Sources of Funds

Principal Amount of Series A Certificates	\$ 640,000,000
Principal Amount of Series B Certificates	800,000,000
TOTAL SOURCES	<u>\$1,440,000,000</u>

Uses of Funds

Subject UAAL.....	\$1,370,623,087
Capitalized Interest	23,014,439
Costs of Issuance*	46,362,474
TOTAL USES	<u>\$1,440,000,000</u>

* Includes premiums on Certificate insurance policies, underwriters' discount and other costs of issuance.

SOURCES OF PAYMENT AND SECURITY FOR THE CERTIFICATES

The Certificates are payable solely from all COP Service Payments which may be received by the Trustee pursuant to the Service Contracts. Such COP Service Payments will include all Scheduled Payments and Service Charges payable by the City under the Service Contracts, corresponding to the principal of and interest on the Certificates, respectively. The City's obligations to make COP Service Payments are unsecured contractual obligations of the City, enforceable in the same manner as any other contractual obligation of the City. **Such payment obligations of the City are not general obligations of the City, and neither the faith and credit, taxing power nor any specific revenues of the City are pledged to the COP Service Payments coming due under the Service Contracts.**